Supreme Court, U.S.
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No. 03-

In the
Supreme Court of the United States

CITICORP VENTURE CAPITAL, LTD,
A New York Corporation,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, AND COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AS ESTATE REPRESENTATIVE OF PAPERCRAFT CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Petitioner, Citicorp Venture Capital, Ltd., respectfully submits this Reply Brief in further support of its Petition for a Writ of Certiorari.

ARGUMENT

Respondent's Brief in Opposition ("Opp.") strives to disguise the nature of the decision of the Third Circuit in this case. That court categorically held that "the American Rule is not implicated" if a bankruptcy court subordinates attorneys fees "pursuant to its equitable powers." (A-8.) Respondent, unable to justify such an unprecedented decision, pretends that the Third Circuit merely applied well-settled principles of equitable subordination. No amount of camouflage, however, can conceal the novelty and breadth of the Third Circuit's actual holding.

1. Respondent claims that the American Rule is not implicated in this case because "Respondent did not collect any attorney's fees from Petitioner, and the Bankruptcy Court did not award attorney's fees to Respondent." (Opp. 15.) This semantic argument ignores the economic reality of the decision below. The bankruptcy Plan of Reorganization (the "Plan") supported by Respondent provided that creditors would receive units consisting of stock and notes; it also calculated a monetary value for those units. The Plan further established an escrow fund to hold the units to which Petitioner claimed entitlement.

The Bankruptcy Court equitably subordinated Petitioner's claims by the amount of Respondent's attorney's fees. In doing so, it placed a dollar value on the cost of litigation fees and awarded the Respondent the corresponding amount in units held in the escrow fund. In other words, the amount that Petitioner would have recovered as a creditor of Papercraft

was reduced by the amount of Respondent's attorney's fees. (A-8.) If this is not an "award of attorney's fees," it is economically indistinguishable from one.

2. Respondent next claims that the Third Circuit's decision was necessary to compensate it for "the harm caused by Petitioner's inequitable conduct." (Opp. 10.) If this were a permissible exception to the American Rule, it would swallow up the rule whole. In any lawsuit, an award of attorney's fees is necessary to fully compensate the prevailing party for the harm caused by its adversary. Nonetheless, the American Rule precludes such awards, for reasons of precedent and policy. This Court recognized, more than two centuries ago, that attorney's fees are part of the damages incurred by a successful plaintiff, but nonetheless held that such damages must go uncompensated "till [the American Rule] is changed, or modified, by statute." *Arcambel v. Wiseman*, 3 U.S. (3 Dall.) 306 (1796). That holding has been undisturbed from 1796 until the Third Circuit's decision in this case.

3. Respondent further contends that the result reached by the Third Circuit is justified by the "bad faith exception" to the American Rule. (Opp. 17.) The Third Circuit's decision, however, is in no way limited to cases of bad faith; that court, rather, unequivocally and broadly held that the American Rule "is not implicated" when a bankruptcy court acts "pursuant to its equitable powers." (A-8.) By definition, a bankruptcy court acts pursuant to its equitable powers in *all* equitable subordination cases. In any event, the "bad faith" exception is an exercise of a court's *inherent* powers, not an exercise of equitable powers. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45-46 (1991). As this Court has held, a court may assess attorney's fees when a party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons. *Alyeska Pipeline Serv. Co. v. The Wilderness Soc'y*, 421 U.S. 240, 258-59 (1975). However, such an award is not an exercise of

a court's equitable power. Rather, a court's exercise of this power "transcends a court's equitable power . . . and reaches a court's inherent power to police itself." *Chambers*, 501 U.S. at 45-56. Moreover, Respondent did not invoke the "bad faith" exception before the Bankruptcy Court, nor did that court ever make any such findings in any of its opinions. (*See* Petition at 7.)[1]

Indeed, the Bankruptcy Court made its reasoning clear: Petitioner breached its fiduciary duty by purchasing Papercraft notes; had Petitioner not breached its fiduciary duties, the Bankruptcy Court reasoned, Respondent would not have had to incur litigation costs. Specifically, the Bankruptcy Court stated that

> The third type of economic harm *caused by [Petitioner's] undisclosed claims purchasing* relates directly to this adversary. [Respondent] filed it to redress the harm caused by [Petitioner] and the fees and costs incurred for its prosecution have further minimized available funds in the reorganized entity.

(A-78.) (emphasis supplied).

In fact, there can be no question that both the Bankruptcy and District Courts based the award of equitable subordination on the finding of Respondent's breach of fiduciary duty in purchasing Papercraft notes — not on its conduct in the litigation.

> [T]he fees at issue depleted funds otherwise available to creditors of this estate *due to conduct in breach of its fiduciary duty*. That is, [Petitioner's] conduct caused the amount available to the estate to pay creditors to be reduced. To assure the creditors the distribution they should have received but for [Petitioner's] conduct,

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[1] Respondent's reliance on cases in which the "bad faith" exception was actually litigated (Opp. 12-13) is thus misplaced.

> I find it necessary to restore . . . the amount of fees and expenses incurred by professionals . . . that would not have been incurred *but for [Petitioner's] breach of its fiduciary duty.*

(A-65.) (emphasis supplied). Consequently, subordination of litigation costs had absolutely nothing to do with any supposed misconduct in the litigation. No such misconduct was alleged in the litigation. The Bankruptcy Court's opinion contains no findings of bad faith, abusive or vexatious litigation tactics. That court expressly based its remedy on the grounds that, but for Petitioner's breach of fiduciary duty, there would have been no lawsuit and, therefore, no legal fees. The District Court affirmed on the same basis.

5. Finally, Respondent wrongly asserts that the "Bankruptcy Court, District Court, and Third Circuit all agreed that, under the circumstances *of this particular case*", Petitioner's claim would be in the amount of Respondent's litigation fees. (Opp. 3) (emphasis supplied). The Third Circuit's decision expressly and unequivocally holds that federal bankruptcy courts need not follow the American Bank Rule whenever they subordinate claims pursuant to their equitable powers. (A-8.) This holding is unprecedented and conflicts with this Court's repeated holdings that the American Rule must be followed except where Congress has explicitly provided to the contrary. (*See* Petition at 9.)

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Dated: July 31, 2003

Respectfully submitted,

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